No. 11251.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

CONSTANCE MAY GAVIN,

Appellee.

Upon Appeal from the District Court of the United States for the Southern District of California.

REPLY BRIEF FOR THE UNITED STATES.

DOUGLAS W. McGREGOR,
Assistant Attorney General.

SEWALL KEY,
HELEN R. CARLOSS,
ARTHUR L. JACOBS,
Special Assistants to the Attorney General.

JAMES M. CARTER,
United States Attorney.

E. H. MITCHELL,
Assistant United States Attorney.

EUGENE HARPOLE,
Special Attorney, Bureau of Internal Revenue.

U. S. Postoffice and Court House
Building, Los Angeles 12,

Parker & Company, Law Printers, Los Angeles. Phone TR. 5206.

TABLE OF AUTHORITIES CITED.

CASES. PAGE

STATUTES.

No. 11251.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

CONSTANCE MAY GAVIN,

Appellee.

REPLY BRIEF FOR THE UNITED STATES.

The Amount Realized by the Taxpayer Was Income Under the Sixteenth Amendment.

This reply brief is submitted to state the Government's position on the constitutional question raised in the taxpayer's brief and not covered in the Government's original brief.

Before stating that position, it should be pointed out that there is no apparent foundation in the record for the statement in the taxpayer's brief (pp. 4, 8) that $100,000 was paid to the taxpayer and her assigns in lieu of a 4/27ths interest in the corporate stock of the Rancho Santa Margarita and certain real estate. In any event, the fact is immaterial in view of the undisputed fact that the money was specifically to be paid out of the funds of certain beneficiaries and not out of the estate of the deceased.

The only other aspect of the taxpayer's brief which merits reply is the assertion that the amount she realized under the contract in settlement of her claim was not income under the Sixteenth Amendment to the Constitution of the United States which provides that—

> The Congress shall have the power to lay and collect taxes on income, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration.

Pursuant to this grant of authority, Section 22(a) of the Revenue Act of 1934, c. 277, 48 Stat. 680, defined the term "gross income" as "gains, profits and income" derived from a number of specified sources including those derived from "sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property" or "gains or profits in income derived from any source whatever." Section 21 defined the term "net income" to mean the gross income computed under Section 22, less the deductions allowed by Section 23.

Section 22 is couched in broad language. *Helvering v. Clifford,* 309 U. S. 331, 334. The Congress intended to exert its power to tax to the fullest extent possible and to reach every sort of income subject to the constitutional power. *Commissioner v. Wilcox* (S. Ct.), decided February 25, 1946 (1946 P-H Tax Service, par. 72,014); *Helvering v. Midland Ins. Co.,* 303 U. S. 216, 223; *Helvering v. Stockholm etc. Bank,* 293 U. S. 84, 89; *Eisner v. Macomber,* 252 U. S. 189; *Irwin v. Gavit,* 268 U. S. 161. Embraced within the definition is the gain that is ordinarily viewed as "income" within the ordinary mean-

ing of that term. See, *e. g., Burnet v. Sanford & Brooks Co.,* 282 U. S. 359, 364; *United States v. Kirby Lumber Co.,* 284 U. S. 1, 3.

If the Government is correct in its position that the amount acquired under the settlement agreement was not an "inheritance" we believe that it necessarily follows under the very nature of the contract that the amount the taxpayer acquired was necessarily income.

The taxpayer did not acquire the consideration from the other parties by "purchase" or "gift" or "bequest." And, if it was not acquired by law through intestate succession, then it necessarily follows that what she acquired was either by disposition of her claim, or in compensation for certain action or nonaction on her part.

In essence, the taxpayer received property in consideration of her surrendering and forbearing further to pursue a claim which she had by virtue of her position as a claimant to be an heir. The transaction may be considered in two different aspects. In one sense the taxpayer surrendered or transferred a "property right," namely, her claim or cause of action against the estate. In another view, she received a payment made to induce her to refrain from an act which might have been detrimental to the beneficiaries under the will. The result is the same in either case and the amount received by the taxpayer constitutes taxable income within the meaning of Section 22(a) of the Revenue Act of 1934, and the Sixteenth Amendment to the Constitution.

Considered from the viewpoint of the disposition of property, there can be little argument that the taxpayer's claim against the estate, a *chose* in action was a property which she could dispose of as she saw fit. Compare

United States v. Safety Car Heating Co., 297 U. S. 88. The taxpayer did dispose of this property by contract for the sum of $206,974.43 in cash and property. Section 22(a) specifically takes into account the income arising from "dealings in property * * *, growing out of the ownership or use of or interest in such property." The taxpayer's transaction with her property is clearly within the scope of this provision.

The amount of the gain is computed under Section 111 of the Revenue Act of 1934 as the excess of the amount realized over the cost basis of the property which in this case is obviously zero. Whether the contract is to be viewed as a sale or an exchange of the taxpayer's "property" the entire gain is income to her under Section 111. Compare *Helvering v. Gowran,* 302 U. S. 238; *Sterling v. Commissioner,* 93 F. (2d) 304 (C. C. A. 2d), certiorari denied, 303 U. S. 663; *Marine Transport Co. v. Commissioner,* 77 F. (2d) 177 (C. C. A. 5th).

The term "income" is defined in *Stratton's Independence v. Howbert,* 231 U. S. 399, 415, and *Doyle v. Mitchell Brothers Co.,* 247 U. S. 179, 185, arising under the Corporation Excise Tax Act of 1909, c. 6, 36 Stat. 11, as the "gain from capital, from labor, or from both combined." In *Eisner v. Macomber, supra,* p. 207, a case arising under the Sixteenth Amendment and the Revenue Act of 1916, the Court accepted that definition with the proviso that it be understood to "include profits gained through a sale or conversion of capital assets." See also *Merchants' L. & T. Co. v. Smietanka,* 255 U. S. 509. The gain realized from the conversion of assets by an exchange obviously comes within that definition. See *Moore v. United States,* 268 U. S. 536. It is assumed at the

present time that gains from exchanges are taxable. See *Groman v. Commissioner,* 302 U. S. 82, 654; *Helvering v. Bashford,* 302 U. S. 454.

The taxpayer's surrender or transfer of her claim to be an heir in return for a valuable consideration, if not technically an exchange, is a dealing in property sufficiently analogous to leave no real doubt of the constitutionality of a tax upon the gain realized therefrom.

If the taxpayer's contract be simply construed as a payment to her for the forbearance or her nonaction in pursuing her claim against the state, it is equally plain that the amount she realized is also taxable. The payment to her added to her wealth of the full value of the property she received. The amount she realized was acquired by contract. It is clear that she was performing certain acts or nonaction in order to realize gain she received. This is income taxable under Section 22(a) as gain "derived from any source whatever."

A payment made to induce one not to act or not to use one's capital, including the resources by means of which she is able to command the services of an attorney in connection with her claim to be an heir of a deceased person, has its source in labor or capital as much as a gain realized through their actual use, and is truly a gain derived from labor or capital or both combined. Thus, in *Cox v. Helvering,* 71 F. (2d) 987 (App. D. C.), the Court held that the payment received upon agreement not to enter upon a competing business was income. The same conclusion was reached in *Salvage v. Commissioner,* 76

F. (2d) 112 (C. C. A. 2d), and the holding was apparently proved in *Helvering v. Savage,* 297 U. S. 106. Also in *Beals' Estate v. Commissioner,* 82 F. (2d) 268, 270 (C. C. A. 2d), the Court said:

> A promise not to work for others or for oneself is no more a conveyance of property than is a promise to enter the promisee's employ. Payment for either promise is income, not proceeds received on disposal of a capital asset. [Citing *Salvage v. Commissioner, supra.*]

In *Sabatini v. Commissioner,* 98 F. (2d) 753 (C. C. A. 2d), it was held that an author realized income by receiving a payment from a publisher for foregoing the right to authorize others to publish his uncopyrighted works.

It may be well also to refer to the cases holding that graft money received by a public official from a construction company is income (*Chadick v. United States,* 77 F. (2d) 961 (C. C. A. 5th), certiorari denied, 296 U. S. 609), and that bribes are income (*United States v. Commerford,* 64 F. (2d) 28 (C. C. A. 2d), certiorari denied, 289 U. S. 759). It is evident that it would make no difference whether the graft or the bribe were paid to an official to induce him to act or to refrain from acting.

It is no answer to say that if the taxpayer pursued her rights successfully in the probate court what she received would not be taxable as income. In the first place, it is assumed that the question as to what constitutes income should be determined with reference to what income would have been realized if something else had been done, whereas the courts have repeatedly recognized that a transaction would give rise to income if carried out in one way while it would not if carried out in another way. See

Davidson v. Commissioner, 305 U. S. 44, 46; *United States v. Phellis,* 257 U. S. 156; *Helvering v. Tex-Penn Co.,* 300 U. S. 481; *Clemmons v. Commissioner,* 54 F. (2d) 209 (C. C. A. 5th); *Bruce v. Helvering,* 76 F. (2d) 442 (App. D. C.); *Kennemer v. Commissioner,* 96 F. (2d) 177 (C. C. A. 5th). See also *Helvering v. Midland Ins. Co., supra; New Colonial Co. v. Helvering,* 292 U. S. 435.

There is, however, a more fundamental difficulty here. There was in this case, on the one hand, a renunciation of a course of action which might, but not positively, have led to a certain result; and, on the other hand, the adoption of a course of action which produced another result. There was not a choice of achieving the same result by different means but a choice of achieving a different result by different means. The taxpayer's argument assumes that if she had pursued her claim, she would have been successful, and a share of the property would have come to her; and hence that under the agreement she merely received part of what would have come to her by inheritance. But this argument assumes what can neither be established nor taken to be true. She might have failed in her claim and received nothing. The most that can be said is that the taxpayer had a highly contingent claim to a part of an estate. She did not realize a part of an inheritance by compromising this claim for she had no inheritance; she merely had a claim to an inheritance through litigation, and she bargained away that possibility. In other words, she forbore further to press a

speculative claim to a part of an estate, which cost her nothing, and received personal property, which was worth $206,974.43. We submit that she thereby realized a gain from an exchange which constituted income under the statute and under the Sixteenth Amendment.

Respectfully submitted,

DOUGLAS W. MCGREGOR,
Assistant Attorney General.

SEWALL KEY,
HELEN R. CARLOSS,
ARTHUR L. JACOBS,
Special Assistants to the Attorney General.

JAMES M. CARTER,
United States Attorney.

E. H. MITCHELL,
Assistant United States Attorney.

EUGENE HARPOLE,
Special Attorney, Bureau of Internal Revenue.

June, 1946.